

**UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
The Honorable A. Bruce Campbell**

In re:)	
)	
SECURITIES INVESTOR)	Case No. 95-1645 ABC
PROTECTION CORPORATION,)	(SIPA)
)	
Plaintiff-Applicant,)	
v.)	
)	
CONSOLIDATED INVESTMENT)	
SERVICES, INC.,)	
)	
Defendant.)	
_____)	
)	
STEPHEN E. SNYDER, AS TRUSTEE)	Adversary No. 02-1547 ABC
FOR THE LIQUIDATION OF)	
CONSOLIDATED INVESTMENT)	
SERVICES, INC., and 100 HAMILTON)	
MANAGEMENT COMPANY, LLC,)	
a Colorado limited liability company,)	
)	
Plaintiffs,)	
v.)	
)	
FLOWWORKS, INC.,)	
a Nevada corporation,)	
)	
Defendant.)	
_____)	

**ORDER GRANTING DEFENDANT’S MOTION TO DISMISS
AND DENYING PLAINTIFFS’ MOTION TO DROP PARTY**

THIS MATTER is before the Court on two motions. The first is the motion of plaintiffs, Stephen E. Snyder, Trustee for the Liquidation of Consolidated Investment Services, Inc. (“Trustee”) and 100 Hamilton Management Company, LLC (“Hamilton”) seeking to drop Hamilton as a party-plaintiff in this adversary proceeding and “substitute” the Trustee as plaintiff (the “Motion to Substitute”). Defendant Flowworks, Inc. (“Flowworks”) opposes this Motion. The second motion before the Court is Flowworks’ Motion Pursuant to F.R.C.P. 12(b)(6) to Dismiss Plaintiffs’ Amended Complaint for Failure to State a Claim (“Motion to Dismiss”).

Before addressing the merits of these motions, a brief summary of the pending claims asserted by the plaintiffs against the defendant and the procedural context in which the Motion to Substitute and the Motion to Dismiss are before the Court is appropriate.

FACTUAL BACKGROUND

As alleged in the Amended Complaint in this matter, the initial, sole plaintiff in this adversary proceeding was the Trustee. The Trustee is the appointed fiduciary in the Securities Investment Protection Act winding-up proceedings of Consolidated Investment Services, Inc., being administered pursuant to 15 U.S.C. §§ 78fff(b) and 78fff-1 by this Court as Case No. 95-1645. In connection with the discharge of his statutory duties, the Trustee in the year 2000 filed a creditor's bill suit in Colorado state court as part of his collection efforts on something in excess of \$14 million of judgments against Norman P. Rounds, the principal of Consolidated Investment Services, Inc. (Amended Complaint ¶¶ 2, 3, 11 and 14). As part of this litigation, the Trustee sued Mr. Rounds' wife, Joan Rounds, alleging Mr. Rounds had fraudulently transferred to his wife (or companies controlled by her) certain valuable interests in companies that owned and managed an office building in Palo Alto, California.

The litigation against Mrs. Rounds was settled in 2000, with assignment by her (or companies controlled by her) of (i) rights to receive cash or other distributions of property from the limited liability company that owned the subject office building; (ii) rights to manage that limited liability company, subject to approval of members as required by the operating agreement of the limited liability company that owns the office building; and (iii) rights to receive payment for the fair value of the manager's interest from any successor manager (such as defendant Flowworks), as required by the operating agreement of the limited liability company that owns the Palo Alto office building. (Amended Complaint, ¶¶ 15 thru 20).

Instead of taking the interests he acquired in the settlement with Mrs. Rounds into his own estate, the Trustee took these rights to manage and rights to receive distributions into a Colorado limited liability company, wholly owned by him and created for the purpose of receiving these settlement proceeds. That limited liability company is plaintiff Hamilton. (Amended Complaint, ¶ 16).

PROCEDURAL POSTURE OF THE CASE

On November 4, 2002, the Trustee filed the complaint in this adversary proceeding naming three defendants: Lewis E. Graham; Flowworks, Inc.; and Lynworth LLC, a California limited liability company. On November 19, 2002, the Trustee filed an emergency motion seeking a temporary restraining order against the three defendants initially named in this adversary proceeding. This temporary restraining order motion sought to restrain the defendants from seeking to remove Mrs. Rounds and a company controlled by her from management of the limited liability company that owned the office building in Palo Alto. On November 22, 2002, the Court declined to issue the

requested temporary restraining order. In doing so, it found, *inter alia*, the Trustee had failed to meet his burden of persuading the Court that there was reasonable probability that the Trustee would prevail on the merits of his asserted claims due to apparent deficiencies in the Trustee's standing and questions as to the Bankruptcy Court's subject matter jurisdiction.

On December 26, 2002, the three initial defendants responded to the Trustee's complaint with a motion to dismiss which raised, among other things, questions concerning the Trustee's standing and this Court's jurisdiction. On January 9, 2003, before the defendants' initial motion to dismiss was addressed by the Court, the Trustee moved for leave to amend his complaint. When leave was granted, the Trustee filed his amended complaint, which added Hamilton as a plaintiff and dropped all defendants other than Floworks.¹

Promptly after seeking leave to amend his complaint, thereby adding Hamilton as a plaintiff, on February 21, 2003, the Trustee filed articles of dissolution of Hamilton pursuant to which all assets of Hamilton, including claims in this suit, were distributed by the Trustee from Hamilton to the Trustee's SIPA estate. One week after having obtained leave to amend his complaint which added Hamilton as a plaintiff, on March 13, 2003, the Trustee and Hamilton filed the Motion to Substitute, seeking to drop Hamilton from this litigation. On March 20, 2003, Floworks, the sole remaining defendant under the Trustee's amended complaint, filed the Motion to Dismiss, focusing again on the Trustee's standing, or lack thereof.

On April 25, 2003, Floworks filed its objection to the Trustee and Hamilton's Motion to drop Hamilton from the suit, arguing that this Court lacks subject matter jurisdiction over claims between Hamilton and Floworks, and that this jurisdictional infirmity could not be cured following initiation of this very lawsuit by liquidating Hamilton into the Trustee's estate and then dropping Hamilton as a party from the litigation.

On May 5, 2003, this Court entered its order directing plaintiffs to file a reply to Floworks' opposition to dropping Hamilton as a party and a response to Floworks' Motion to Dismiss, requiring that such brief should not exceed ten pages, and noting explicitly that if this length limitation was not complied with, the Court would not consider the brief. It was not, and the Court has not. Plaintiffs' brief, which ignored the Court's length limitation, was filed on May 19, 2003. Plaintiffs followed this up with a Motion for Leave to Supplement Complaint on May 27, 2003. This document, for the most part, simply supplements Plaintiffs' May 19 brief, further compounds Plaintiffs' disregard for the Court's length limitation set for that brief, and will not be considered by the Court in ruling on the pending Motion to Substitute and Motion to Dismiss.

¹There is some uncertainty in the law as to whether Rule 15, Rule 21, or both govern the addition or deletion of a party. See Wright, Miller and Cooper, Vol. 6 FEDERAL PRACTICE AND PROCEDURE, Section 1474 & 1479 (2nd Ed. 1984). Regardless, the Trustee sought leave of the Court to amend the complaint and obtained it, thus adding and dropping parties without reference to Rule 21.

CLAIMS IN PLAINTIFFS' AMENDED COMPLAINT

The Trustee and Hamilton's amended complaint alleges three claims. The first is for a declaratory judgment. Specifically, it seeks,

a declaratory judgment in their favor and against Floworks to the effect that the assignment of the [Palo Alto building owner limited liability company's manager's] right to the Retiring Managers Payment to Hamilton pursuant to the Settlement Agreement is fully valid and effective, and that Hamilton is entitled to receive such payment and to negotiate and, if necessary, arbitrate the amount of such payment with Floworks. (emphasis added). (Amended Complaint, ¶ 51).

The second claim for relief in the amended complaint seeks an order, "directing that Floworks proceed with binding arbitration of the Retired Managers Payment due to Hamilton." (emphasis added). (Amended Complaint, ¶ 56). The third claim in the amended complaint seeks imposition of a constructive trust and equitable lien in favor of Hamilton upon all of Floworks' contract rights in the limited liability company that owns the Palo Alto office building. (Amended Complaint, ¶ 61).

RULING

The three claims asserted in plaintiffs' amended complaint are claims of plaintiff Hamilton that seek relief against defendant Floworks: declaring that an assignment to Hamilton was effective; directing that Floworks arbitrate with Hamilton; and establishing a constructive trust or equitable lien in favor of Hamilton. The allegations in plaintiffs' amended complaint are clear; the Trustee established Hamilton for the purpose of receiving the fruits of the Joan Rounds settlement and possibly managing the Palo Alto office building enterprise. The disputes of this litigation are Hamilton's disputes. Except in connection with dissolution of Hamilton by the Trustee after this suit was filed, the amended complaint offers no pretense that the Trustee himself has standing to assert claims against defendant Floworks.

This Court is without subject matter jurisdiction over the disputes the Trustee and Hamilton have brought before it — disputes between two third parties to this insolvency proceeding, Hamilton and Floworks. *In re Gardner*, 913 F.2d 1515 (10th Cir. 1990).² Neither the fact that Hamilton is wholly owned by the Trustee nor that the Trustee seeks to invoke this Court's jurisdiction in administration of a SIPA case expands this Court's limited "related-to" jurisdiction to the instant

²The limitations of this Court's "related-to" jurisdiction recently were dealt with at some length in this Court's application of *Gardner* in the case of *In re Professional Home Health Care, Inc.*, 2002 WL 1465914 (Bankr. D. Colo., July 2, 2002).

controversy.³ This dispute does not involve either the fiduciary of this SIPA estate, in his capacity as such, or property of that estate. When the Trustee chose to take whatever valuable property rights he received in the settlement with Mrs. Rounds and place them in a separate entity, only the ownership interest in that entity (Hamilton) remained property of his estate. The disputes and property of the entity are beyond the jurisdictional reach of this Court. *See In re Fedpak Systems, Inc.*, 80 F.3d 207 (7th Cir 1996) (where estate's interest is transferred, estate no longer has standing with respect to disputes between transferee and another, and the bankruptcy court no longer has jurisdiction over the disputes).

The Trustee has apparently sought to bootstrap the standing and jurisdictional problems he has created by causing the dissolution of Hamilton and distributing its assets in dissolution, including its claims in this adversary proceeding, to his SIPA insolvency estate. The difficulty in this strategy is in its timing. The Trustee would seek to cure this Court's lack of subject matter jurisdiction well after this case was filed: the case was filed in November 2002; Hamilton was dissolved in February 2003, after standing and lack of jurisdiction became issues in the case. Jurisdiction is generally to be determined at the time an action is commenced. *See Gard v. Teletronics Pacing Systems, Inc.*, 859 F. Supp. 1349, 1354-55 (D. Colo. 1994); *E.K. Carey Drilling Co. v. Murphy*, 113 F. Supp 226, 228 (D. Colo. 1953); Wright, Miller and Cooper, Vol. 13B FEDERAL PRACTICE AND PROCEDURE, Section 3608, "Time of Determining Diversity Jurisdiction" (2nd Ed. 1984).

Upon filing this case, the disputes at issue involved neither the Trustee nor property of his estate. The Trustee's efforts now to drop Hamilton and proceed as if he were Hamilton or as if

³Section 78eee(b)(2)(A)(i) does not expand the Court's jurisdiction over this matter because the plaintiffs' suit does not involve property of the debtor or the estate. 15 U.S.C. § 78eee(b)(2) provides:

(2) Jurisdiction and powers of court

(A) Exclusive jurisdiction

Upon the filing of an application with a court for a protective decree with respect to a debtor, **such court--**

(i) shall have **exclusive jurisdiction of such debtor and its property** wherever located (including property located outside the territorial limits of such court and property held by any other person as security for a debt or subject to a lien);

(ii) shall have **exclusive jurisdiction of any suit against the trustee** with respect to a liquidation proceeding; and

(iii) except as inconsistent with the provisions of this chapter, shall have the jurisdiction, powers, and duties conferred upon a court of the United States having jurisdiction over cases under Title 11, together with such other jurisdiction, powers, and duties as are prescribed by this chapter.

Hamilton's assets were his own, appear to be a thinly-veiled effort to manufacture subject matter jurisdiction in this Court, where there was none on the filing of this adversary proceeding.

For the reasons stated above, the Trustee's Motion to Substitute is denied, and Flowworks' Motion to Dismiss is granted, without prejudice to the Trustee to refile in any Court of proper jurisdiction.

DATED:

BY THE COURT:

A. Bruce Campbell
United States Bankruptcy Judge